

97-84013-9

Kirkbride, Franklin Butler

The journey of a cheque

[Philadelphia, Pa.?)

[1911?)

97-84013-9
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308	
2	
Box 45	Kirkbride, Franklin Butler, 1867-
	The journey of a cheque, specially prepared, by Frank- lin B. Kirkbride ... [Philadelphia? 1911?]
	14 p. 23 ^{cm} .
	"Sent out with the compliments of George H. Paine, Philadelphia, Pa." Volume of pamphlets
	1. Banks and banking—U. S. 2. Checks. i. Title.
	Library of Congress
	HG1616.K5
	12-1148
	only ed

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TECHNICAL MICROFORM DATA

FILM SIZE: 35 mm

REDUCTION RATIO: 11:1

IMAGE PLACEMENT: IA ☒ IIB

DATE FILMED: 2-4-97

INITIALS: PB

TRACKING # : MSH 20988

FILMED BY PRESERVATION RESOURCES, BETHLEHEM, PA.

The Journey of a Cheque

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Sent out with the compliments of George H. Paine, Philadelphia, Pa.

THE JOURNEY OF A CHEQUE.

A banker recently asked what was meant by the expression, "co-operative competition," which had been used in a discussion of the plight in which big business now finds itself. The term is not new, but its every-day application has been obscured by the company of legal phraseology with which it has so often been associated that the obvious meaning of it has almost been lost sight of. Competition, fair and unfair, is today on men's lips and in their minds, it is discussed and argued about in and out of court, on the platform, in the press, and wherever the interests of "trust" and "independent" clash.

Leave for a little the lawyers and their briefs and consider instead a few of the facts which bear upon the relation of man to man in business, and upon which permanent success is built—the co-operation which is essential in every community and the competition which is equally necessary to progress.

As an example, I am going to describe the journey of a cheque, which illustrates the co-operative and competitive machinery of the banks, the most perfect type of co-operative—competitive organization.

The names of banks often indicate very clearly their origin. "Farmers and Mechanics," "Importers and Traders," "Merchants," "Manufacturers," "Shoe and Leather," and "Planters," are examples of names indicating institutions organized by men in kindred lines of business to lend and obtain such aid in their financial transactions as comes from co-operative-competitive organization. The promptings which have led to the organization of most banks have not come primarily from a desire for gain, but from communal pride or fraternal sentiment, with a correct value placed on co-operative competition.

In a New England community where the abilities of its capitalists and the skill of its workmen have for years maintained the reputation of the products of its industries, the buyer of one

of the large and successful mills has just closed a contract for the purchase of raw material from a planter in one of the southern states.

The mill needs this raw material and the planter is anxious to dispose of it. The mill has large sums invested in real estate and machinery, raw material, and accounts due it. Some of these are assets technically called "liquid," because from their nature they can be quickly transferred from one party to another. The planter must have the cash. He has bills to pay, and cannot wait until the mill can manufacture the raw material and turn the product into cash. He must have the money at once. On the other hand, the mill needs the material. In the banks, the strong boxes of the community, in charge of carefully selected directors and officers—the watch-dogs—the mills, the merchants, the farmers, and all the rest of the community have placed their idle wealth so that these banks hold the surplus of the community. Make no mistake about it, all this idle wealth is real, genuine, true wealth. There is no doubt of this. The banks have made sure of it.

The mill has been and is of the greatest benefit to the town. The community recognizes this and is disposed to co-operate in every legitimate way to perpetuate its existence and success. The treasurer of the mill calls upon the directors of the bank, to all of whom he is known, and who also take a local pride in the standing of the mill and the investment it represents. He places before the directors the particulars of the transaction and declares his need of that co-operation, to give which the bank was organized. As a result, the treasurer places in the hands of the bank documents by which the mill agrees, practically, to convert some of its materials into cash, or the equivalent of cash, by a certain time, and in the event of failure to do this, to permit the bank to convert into cash enough of the mill's assets to reimburse the advance which the documents specify should be made to the mill by the bank as the representative of the community. It may be that among the directors of the bank sit the owners of competing

mills, and the advance is made possible by the bank's holding or having at its disposal the idle wealth of these competing mills. Moreover, each mill knows that when its turn comes, it will have the same assistance on the basis of its needs and deserts.

After the treasurer of the mill completes his arrangements with the bank, he wires the planter to ship the raw material and to send forward the bill of lading to evidence the delivery of the raw material to the railroad, which receives it as the agent of the mill and is responsible for its safe delivery. The planter sends by mail to the mill the bill of lading issued by the railroad. Back of it is the real property, the raw material shipped. His invoice shows the amount agreed upon as the value. On the invoice the planter states his terms, giving a special discount for quick payment. To secure this discount the mill seeks the co-operation of the community in putting through the transaction, one from which all derive a benefit.

Having received the bill of lading, a document representing real property just as a deed to real estate represents real property, the treasurer of the mill, without hesitation, draws a cheque upon the mill's deposit account kept in a New York bank, where the proceeds of the loan have been deposited, because New York funds can be more quickly and cheaply transferred than a cheque drawn on its local bank. This cheque is mailed to the planter who deposits it in his little local bank.

The planter's local bank enters upon its books a credit to the planter for the amount of the cheque which is sent to its depository or supplementary strong box, a national bank in a large, nearby southern city. This bank gives credit to the bank from which it received the cheque, and forwards it on the same day to its supplementary strong box, a bank in New York. The New York bank gives credit for the amount of the cheque to the bank from which it is received. The next morning the representative of this New York bank takes the cheque with the thousands of others it has received in the course of business to the Clearing House on Cedar street, where representatives of all

the New York banks meet, bringing the cheques their respective banks have received which are drawn for payment on other New York bank members of the Clearing House.

This Clearing House is another example of co-operative competition. Each of the banks represented is actively engaged in competition with all of the other banks, yet they co-operate to improve service, to control and regulate methods and compel their observance, as well as to extend aid to the weakened, when aid is needed and justified.

Here, through the Clearing House, in an incredibly short time, the cheque is passed to the representative of the bank on which it is drawn for payment. He takes the cheque to the bank, and after it has passed the scrutiny of the paying teller it is charged by the bookkeepers against the deposit account of the New England mill, thereby reducing its credit balance by the amount for which the cheque is drawn. The cheque is then filed in a drawer with others drawn by the mill, but paid previously. At the end of the month all these cheques are mailed to the mill in an envelope, which shows the balance on deposit at the beginning of the month, the deposits made, the cheques paid during the month, and the amount on deposit at the close.

The transaction, involving the sale and purchase of many thousands of dollars' worth of goods, has been effected without handling any actual money. Instead, the transfer of the location and ownership of the goods has been followed by the transfer of credit balances, representing absolute and real property, corresponding in amount to the sale value of the goods (measured in dollars). The mill has secured the goods, and in offset has reduced its credit balance in a New York bank, while the seller has parted with his property, and in exchange has secured a credit balance in his local bank, which in turn has increased its own credit balance in another southern bank. This bank has also increased its balance in a New York national bank, while all three banks have assumed a liability to repay the money on demand.

The transaction in its finality has increased the deposits in one, and correspondingly reduced the deposits in another New York bank. The various transfers of credit have taken place without any effort to the buyer or the seller of the goods. At every step of the transaction, in the journey of the cheque, and back of all the credit balances stand real, absolute property, made liquid, or flowable, by means of co-operative methods practiced by competing organizations.

The round trip which the mill's cheque has taken is typical of myriads of transactions which are daily taking place, the only difference being in the length of the journeys and the number of stopping places on the way. The shortest trip is where the cheque stays in the town where it is drawn and deposited in the same bank. In such cases the bank's deposits are not increased nor lowered, the transaction simply resulting in the increase in the balance of one depositor, while that of another is correspondingly decreased. On the other hand the cheque may be sent to some far distant part of the world, in which case, in addition to affecting the balances of banks and individuals through whose hands it passes, it affects the balances between the countries through which it passes, and then it has to be converted from dollars into the equivalent in the currency used in each country. These transactions between countries, "foreign exchange" as they are called, are fundamentally similar to the transfers of domestic credit balances, although there are elements entering into these transactions which make them somewhat more complicated.

In all these transactions where no currency passes, the cheque is simply the authority for the transfer of the credit balance, but the fact must not be lost sight of that these cheques are issued covering real property and assets as much as does currency, and that there is no crime greater in the eyes of the bank or the law than issuing a cheque that does not stand for absolute, actual property. These transfers of credit balances which passed through the Clearing Houses of the United States in 1910 were

in amount one hundred times greater than the total stock of gold in the country.*

Were it necessary to use actual gold or currency instead of cheques in transferring credit balances, the labor involved would be enormously increased. Not only would the transfers be made much more slowly and laboriously, but the total gold supply of the country would prove utterly inadequate for the purpose, and the volume of business transacted would shrink correspondingly.

In following the journey of a single cheque we have considered the direct effects of the transaction on the purchaser and seller of the goods, and on the various banks which have handled it. We have also noted that a number of banks have, without any charge, put their facilities for transferring credit balances at the service of the two parties to the transaction. We have seen all working smoothly, on schedule time and satisfactorily, and what is most remarkable, without a guiding head.

Now let us follow the same cheque on the same journey, but under different circumstances. All has gone well until the planter receives the cheque and deposits it in his little local bank. The next morning he sees in his paper scare headlines and the story of the collapse of some large enterprise. The paper gives an hysterical version of the probable effect of the collapse on business conditions generally. Unquestionably, as is always the case, the condition of the enterprise was generally known. No conservative agent, honorable business man, nor reputable banker had anything to do with it. Those responsible for its existence and accountable for its conduct were gamblers pure and simple. Those involved were tempted with promises of impossible reward to risk their all. Every banker knows that the failure ought to have no effect upon the market or sound business, but every banker also knows that when driven to the last analysis he is absolutely and positively alone, that the banking system of which he is part is without a guiding or controlling head, that it is a case of each

* Modern Banking by Frank A. Vanderlip, p. 64.

bank for itself, and that the very laws themselves prevent him from having any connection at all with any other bank beyond the mere granting of courtesies. Every banker knows the effect upon his bank of crazed and frightened depositors. He knows that he has agreed to pay on demand in DOLLARS, in CURRENCY, the amounts of the credit balances shown by his books, when they are demanded.

The planters' bank has the cheque, but is it good? The New York bank may become involved, although this is unlikely, but the southern banker is taking no chances for his profits are too small to admit taking risks, and so he notifies the planter that he must not draw against his credit balance until "final actual payment" of the mill's cheque is reported. In the meantime the goods have gone and obligations are coming due. The planter has to ask his creditors for an extension of time in which to pay them. It is whispered about that the planter is in trouble, and the whole community knows that he is largely interested in the little local bank. Questions are asked as to its strength. The more timid of its depositors decide to take no chances, draw out their balances and transfer the coin to teapots and stockings, while the bank, to meet its obligations, is forced to sell securities at a panic loss rather than face a run which may close its doors. The bank instead of being able to aid the business people of the town and to allay the growing fear, is forced to decline to give credit, and instead is obliged to call for the payment of loans. Now the business men of the town begin to feel anxious themselves. They have bills to meet and, although trade is good and profits are being made, actual cash and extensions of credit are not so easy to obtain. They begin to press their customers for the payment of bills. The circle of anxious people grows. As anxiety spreads and credits are curtailed, business falls off. Now comes another failure. This time it is a small, but honest, tradesman, whose notes the bank has been unable to discount. He owns his home and his store, but he has unexpectedly been refused credit and is unable to pay cash for or sell his wares as a result of conditions, not

his fault, which he could not foresee. Now there is genuine cause for alarm, fear grows, and the area of anxiety spreads. Each man is for himself. The cry is "*saute qui peut*", for a very real, but altogether needless, panic has come. While confidence and co-operative competition exist all goes smoothly, but distrust and competition without co-operation have separated an orderly company into a distraught rabble. And why? There must be some defect in our banking laws or the thing would not have happened. Let us see.

The charter of a bank is nothing more than a certificate of the nation or state that certain people, having complied with the requirements of the law, are therefore authorized to do a banking business according to the rules made by the people through their representatives in national or state governments. Its bank books, held by depositors, constitute evidence of the confidence and faith of the people in a bank, and are evidence of a grant by these people of a franchise, revocable at will, without notice, through simply drawing out the balances entrusted to the bank for safe keeping. Let there be even the slightest breath of suspicion, the deposits will simply fade away. Confidence in its integrity and business ability leaves the bank free to use its depositors' money as it will, always subject to the limitations fixed by its charter and the banking laws under which it operates. Its return comes through the use it is enabled to make of the money and credit balances entrusted to its care in the purchase of stocks, bonds, and other securities, and in loaning against collateral securities or on the mere promise to pay of responsible borrowers.

The bank is more than a mere safe deposit vault or an agent to facilitate the exchange of credit balances. Upon it rest a responsibility and duty, similar to that devolving upon the National Government, to see that the evidences of credit balances which it creates or accepts are based upon real property. For currency in any form is only of value as it represents or is secured by tangible assets of some sort. The bank not only collects the cheque, but becomes responsible for it, and this responsibility being assumed

in turn by each bank through whose hands the cheque passes, the mere order to pay of an unknown individual is received freely and gladly for its face value, because of the bank's assurance that there is real property behind the cheque.

Now consider the indirect result of the transaction we have followed, one which may have a very direct effect on the business of the mill and on the producer of the raw product which it has bought.

In the manufacturing town in the North there are a large number of mills making products of the same general character, and in the agricultural community in the South there are also many individuals engaged in growing the same crops. In both communities, as we have seen, competitors are depositors in or borrowers from the same banks, some even sitting side by side on their Boards of Directors. The mills with idle money are, through the medium of the bank, permitting other mills to use their funds and compete with them, while in the South increased acreage is being planted and larger crops are being raised through credit given by the local bank based on deposits or other property of prosperous planters, who thus supply their rivals with the capital required to compete successfully. If the competition is fair, it is to the advantage of banks, depositors and borrowers alike that additional wealth should be produced, regulated by a never-failing law of supply and demand, which checks over-production and stimulates under-production through falling or rising prices.

But how necessary where the mill's money is being used by its competitors that dishonesty in every form be driven out, that character, honesty, and ability be made the test of those who shall be entitled to benefit through this "co-operative competition," and that unfair competition be made absolutely impossible. To make this certain two things are necessary; the constant exercise of a police power which will make unfair competition both unprofitable and disgraceful, and an intelligent control of cur-

rency and credit which will always provide for the needs of legitimate business.

The United States Army is stationed in small army posts scattered throughout the country, but when trouble is brewing in Mexico a rapid concentration on the Texas border produces a formidable army, adequate to cope with any possible emergency. The preparation for possible trouble undertaken under the direction of a single cool and firm executive not only allays fear, but prevents strife.

Just so the financial resources of the people of the United States are concentrated in reserve posts strategically located and well officered; banks we call them. All goes well as long as confidence exists everywhere. But, as we have seen, let fear or suspicion arise that trouble is coming, let a single bank, dragged down by failure, no matter what the cause, repudiate its promises to pay, and the system begins to go to pieces. A breath of suspicion that all is not well is like dropping a stone into the clear water of a placid pool. The disturbance extends in every direction until finally the entire surface may be affected.

Instead of its being known to all that there is some one having ample authority to rush help to the crippled post to prevent the possibility of a growing unrest or incipient panic, each is compelled to entrench itself, by calling loans and refusing extensions of credit when and where they are most needed, and to prepare single-handed for the siege which seems to threaten, and its own action is likely to help bring on. It is unthinkable that sane business men see no menace to themselves in such a situation, no necessity for a change. The banks have already demonstrated their trustworthiness by operating as they have on the basis of mutual confidence. Their directors and officers have a clear comprehension of what is needed.

Consider the 28,000 national banks, state banks, and trust companies, all independent of each other and competing, but at the same time co-operating with each other, yet without the power to unite against a common enemy, until driven by panic and with-

out warrant of law, they are forced by sheer necessity to improvise temporary defences to prevent their utter annihilation. Consider their Clearing House Associations, through which the financial institutions of a particular city or district have united for the purpose of facilitating the payment of each other's obligations, and through which the credits of a nation of over ninety million people are swiftly, surely, and at little or no cost transferred at will.

The cheque stated in terms of our standard of value, the dollar in gold, signed by the depositor, is today the medium of exchange instead of the wampum which the Indians passed from hand to hand. But while you and I, except in panic periods, can draw our cheques at will as long as there is any balance in our deposit accounts, obsolete and absurd laws make it impossible for our banks to organize legally to meet the demands of legitimate business, and therefore we go from one extreme, a plethora of idle money, to the other, the scarcity of panic periods; and we fight shy of changing our banking laws lest the bogey of Wall street devour us. We forget that the financial institutions of this country have been brought into existence to meet the needs of legitimate business, that the directors of our banks are first of all business men, and that our deposits are where we put them and to be used as we permit; nor do we stop to realize how much money and credit on deposit in New York City is put there by banks and individuals from every part of the country who unconsciously realize the necessity for a central exchange for credits and the advantage of drawing funds on a point recognized from one end of the country to the other.

A frightful and costly civil war was needed to weld these United States into an enduring nation; today competing States choose the leaders of the nation and co-operate gladly in obeying the laws which the people have passed and which it is the duty of their chosen leaders to enforce.

Not until this country has a system of currency and credits under such direction and control that it can be moulded to meet

the needs of legitimate business, will loss from needless panics and the wide fluctuation in rates of interest and discount, and in prices, so disastrous to the farmer and the merchant, and often so profitable to the speculator, be done away with.

There must be a central control. The success of the Clearing House idea typifies locally what is needed nationally, both in times of prosperity and panic. Thus guided and controlled, with present defects eliminated, we as a people will secure an equal opportunity to share in the benefits and advantages, not only at home, but in the markets of the world, which the more logical systems of the older European nations have given them.

Consider finally President Taft's words: "There ought to be some central authority that could take over the quick assets of the banks in the form of business paper and issue bank notes on the faith of it to meet the exigency arising at any time in a demand for money. If vested in one person or set of persons the business can be intelligently done, panics avoided and money sufficient for the purpose of business constantly kept on hand. * * * Such a system is absolutely necessary for the progress of the business of this country. We must have a system in which the merchants have confidence that it will be scientifically run, and with a view only to the public interest."

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